

February 28, 2003

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STATE LEGISLATIVE UPDATE

State Budget Update

Two documents were recently released which will be important in the State budget resolution discussions. The first is a memo, enclosed as Attachment I, by the Office of Legislative Counsel responding to a request from Speaker Wesson inquiring whether the new revenues raised to pay for the Governor's \$8.3 billion realignment proposal are State General Fund dollars that must be shared with schools under the Proposition 98 guarantee. The second, "A Plan to Balance the Budget Without Tax or Fee Increases", enclosed as Attachment II, was presented by Senate Minority Leader Brulte at the "Big 5" meeting yesterday of Legislative Leaders and the Governor. The following is a summary and analysis of both documents.

The Legislative Counsel Memo

The Legislative Counsel's opinion is a legal response to the question raised by the Speaker as to whether the new realignment revenues, deposited in a realignment fund, could be allocated entirely to counties to pay for the costs of transferred programs or whether they constitute General Fund revenues that would increase the State's required minimum funding level for schools.

The opinion basically concludes that the new fund does not pass the legal/constitutional test for a special fund because the Legislature would continue to retain complete authority to redirect the revenues if it saw fit at some future time. Consequently, the new revenues are really part of the General Fund and thus subject to Proposition 98's minimum guarantee.

Based on the assumptions about General Fund revenue and the Proposition 98 minimum guarantee in the Governor's proposed budget, approximately one-half of the first \$7 billion resulting from increased revenues, either from an improved economy or a tax increase, would have to be shared with schools to pay the "maintenance factor" created in FY 2001-02 when the State suspended the minimum funding level due to insufficient revenues. Consequently, the \$8.3 billion tax increase proposed by the Governor would yield \$4.8 billion for non-education programs, leaving the Governor's realignment proposal underfunded.

It is also noted in the opinion that these new revenues, which would be a part of the General Fund, and the corresponding appropriations would be subject to the State Appropriations Limit. According to the Legislative Analyst, the gap between the FY 2003-04 limit and the Governor's proposed spending level is \$6 billion. Consequently, there would not be room under the spending limit to accommodate the entire \$8.3 billion of realigned spending, none of which falls into the categories exempt from the limit - subventions to schools and local governments, capital outlay, and tax relief.

While not mentioned in the Legislative Counsel's opinion, it is worth noting that the same legal/constitutional deficiencies applied (and continue to apply) to realignment legislation enacted in 1991. In order to discourage legal challenges, a number of "poison pills" were included in the realignment statute, including one that would repeal the realignment sales tax if an appellate court ever held that the proceeds were subject to the Proposition 98 funding guarantee. The same kind of "solution" could be used again. Citing the Legislative Counsel opinion, the Senate Republican budget proposal does not support "realignment and its associated tax increases". However, the Governor responded to the opinion saying: "Clearly this is another challenge that we have to work out with the lawyers to get us all on the same page. We believe the proposal remains viable, and we'll work with the Legislative Counsel to see if we can't persuade him of that."

The Senate Republican Budget Plan

The Plan simply and clearly outlines an alternative approach to balancing the State budget based on different priorities than those of the Governor, the primary difference being to avoid imposing any tax or fee increases.

The Republican Plan starts from the Governor's budget numbers but then indicates those features it does not support, as well as the additional measures it proposes for replacement. In terms of basic approach, the biggest difference is that the Republican Plan relies upon borrowing to balance the budget over two years, rolling over a

\$3 billion budget year deficit from the budget year into FY 2004-05. In addition, by assuming a 7 percent, or a \$5.1 billion across-the-board reduction, in all General Fund spending in FY 2003-04 (in addition to an annual \$500 million "contribution" by local governments) and imposing a spending freeze for three years at a level that is roughly \$4.5 billion to \$5 billion below the Governor's spending level (including realigned programs), the Plan achieves a \$700 million reserve in FY 2004-05 and a \$10 billion reserve in FY 2005-06.

The major policy differences with the Governor's plan include: rejection of all tax and fee increases and the realignment proposal financed by the Governor's tax increase; rejection of the elimination of the VLF backfill in favor of a three year "local government contribution" of \$500 million starting in the current year; rejection of the shift of redevelopment funds to schools; rejection of the \$1.5 billion in new revenue from Indian Gaming; and rejection of the elimination of the Williamson Act. In addition, the Plan includes over \$3 billion in one-time revenues or expenditure shifts not recommended by the Governor. Finally, the Plan accepts the Governor's recommendation to continue the deferral of reimbursements for State mandated programs but also proposes the repeal of mandates so that local governments can eliminate currently mandated services.

The principal weakness in the Plan is the 7 percent across the Board reduction in the expenditure base that is then frozen and carried forward two additional years. Across the board reductions are easy to propose because they are conceptually simple, seemingly fair since all programs are treated the same, and so abstract that they do not engender an immediate political backlash as happens when popular programs are targeted for reductions. But in fact all programs, popular or otherwise, will need to be both reduced and prevented from growing to meet demand in order to achieve the level of savings assumed. Some programs, however, are more "important" than others and once hearings focus on program impacts, as Senator Brulte suggested that the Legislature might exempt some areas of the budget such as schools (32 percent or 42 percent of the base, depending upon whether higher education is exempt) and prisons (another 6 percent). In addition, an across-the-board reduction is not possible for programs that have a Federal mandate of effort requirement, such as TANF/CalWORKs, or a court-imposed level of service. Moreover, reductions in many Federal programs, such as Medicaid, will result in the loss of Federal revenue that will magnify the actual size and impact of the cuts. In short, exemptions tend to multiply very quickly and before long the percentage reduction that needs to be made in the remaining base has doubled or tripled to a level that devastates those services.

Finally, while kinder to local governments in general, and counties in particular, than the Governor's VLF budget proposal, the Plan requires an annual contribution by local governments of \$500 million starting in the current fiscal year. While the Plan suggests that the method of contribution would be negotiated with local governments, much of the cut would probably be taken out of the VLF backfill. In addition, the Federal-State programs that counties administer would be subject to the 7 percent (or greater) across-the-board reduction, resulting in major cuts in health and social services.

Assembly Action on the Budget

The Assembly adjourned for the weekend yesterday without taking action on the "de-linked" budget reduction bills passed by the Senate. Republicans took them to task for their failure to act, saying that delay will force the State to run out of money in May.

We will continue to keep you advised.

DEJ:GK
MAL:JR:ib

Attachments

c: Executive Officer, Board of Supervisors
 County Counsel
 Local 660
 All Department Heads
 Legislative Strategist
 Coalition of County Unions
 California Contract Cities Association
 Independent Cities Association
 League of California Cities
 City Managers Associations
 Buddy Program Participants